

**BEFORE THE
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COMPETITION IN THE RAILROAD INDUSTRY**

Comments of

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E.I. du Pont de Nemours and Company ("DuPont") submits these comments in response to the "Notice" served by the Surface Transportation Board ("STB" or "Board") on January 11, 2011, in Ex Parte No. 705, *Competition in the Railroad Industry*. Pursuant to the Notice, the Board has scheduled a public hearing and solicited written comments on the current state of competition in the railroad industry and policy alternatives to facilitate more competition. DuPont is pleased that the Board has recognized the need to reassess its competition policies in light of the significant changes that have occurred in the rail industry since the passage of the Staggers Act. DuPont strongly urges the Board to modify its policies to encourage greater rail competition, and in so doing, reduce the need for regulation of the rail industry.

DuPont is a member of the American Chemistry Council, the Chlorine Institute, and the National Industrial Transportation League, which have filed Joint Comments as part of a coalition of trade associations and industry organizations. DuPont supports the Joint Comments, and through these comments, adds examples of reduced rail competition based upon the direct experiences of DuPont.

I. Statement of Interest

DuPont is a global corporation founded over 200 years ago on the banks of the Brandywine River in Wilmington, Delaware. Initially, DuPont made only one product, black powder. A

century later, its focus shifted to chemicals, materials, and energy. In our third century, we are bringing together biology and chemistry to meet societal needs for safe and abundant food, alternative fuels, and other sustainable solutions to enable a better, safer and healthier life for people everywhere. DuPont has revenues of over \$30 billion a year, with over 210 sites in more than 90 countries and over 60,000 employees. In the United States alone, DuPont employs about 36,000 workers in 33 states.

DuPont relies heavily upon rail transportation to conduct its business. Indeed, America's freight railroads have been vital to DuPont operations since 1858 when the Pennsylvania Railroad first transported its products. In 2010, DuPont shipped or received over 46,000 rail cars of more than 100 commodities throughout North America.

Over the past 150 years, DuPont has been witness to many changes in the rail industry. DuPont was troubled by the financial decline of the rail industry in the 1970s, and applauded the improvements that followed passage of the Staggers Act. But, DuPont also was concerned when the former Interstate Commerce Commission ("ICC") effectively neutered the competition enhancing provisions of the Act, which were an important tool to implement the rail transportation policy to allow competition to replace regulation to the maximum extent possible. See 49 U.S.C. § 10101(1). As the rail industry consolidated, its market power grew, and over the past decade, DuPont has experienced the negative impacts of that market power first-hand. In fact, DuPont currently is pursuing its fifth rate reasonableness case in five years to check the consequences of that market power. The fact is that DuPont would much rather rely upon true rail competition and collaborative negotiations with the rail carriers, instead of regulation, to obtain reasonable rates and service.

II. Reductions To Rail Competition.

There have always been certain types and volumes of traffic that were captive to rail service. Even traffic that could theoretically move by truck could not always do so practically or economically, particularly in large volumes or over long distances. But so long as the rail industry remained diverse, there could be effective geographic competition and occasional intermodal competition. Significant changes, however, have negatively altered the competitive landscape.

A. Railroad Consolidation

In just thirty years, rail carrier consolidation has substantially reduced the number of Class I railroads in this country from over forty to seven. Moreover, only two railroads at best cover most geographic regions, as mergers have created duopolies in the eastern and western halves of the country. Union Pacific Railroad ("UP") and BNSF Railway ("BNSF") service the majority of traffic in the West, while Norfolk Southern Railway ("NS") and CSX Transportation, Inc., ("CSXT") service the majority of eastern traffic. The remaining Class I railroads operate less extensive rail networks in this country and possess a comparatively small market share when compared to the four Class 1 railroads named above. The ultimate effects of consolidation upon rail competition have been to reduce geographic competition and extend bottleneck segments.

Geographic competition has suffered in two ways. First, a greater portion of production capacity for many commodities has been consolidated on one or two railroads. When that occurs, a railroad can be more confident that it will haul the product regardless which supplier gets the business. Therefore, the railroad can focus on equalizing its margin to all the suppliers it serves at a higher level without concern that, if one supplier loses business to another, the

railroad also will lose that business. Instead of competing, the railroad can focus on margin enhancement.

The second way that geographic competition has suffered is the protection of single line movements through the artificial division of markets. For example, assume that there are two suppliers of a commodity, one on Railroad A and the other on Railroad B, and that there are two purchasers, also split between Railroads A and B. If Supplier A wants to sell to Purchaser B, it must obtain a joint rate from Railroads A and B. Because Railroad B will want to protect the business of Supplier B, it will quote a much higher rate to Supplier A. Railroad A similarly will seek to protect the business of Supplier A against competition from Supplier B. Neither Railroad needs to compete against the other to accomplish this result; they simply use their market dominant position over each Purchaser to determine which Supplier has the lower costs. The end result is a division of the market between Railroads A and B. Thus, when just two railroads dominate an industry, their geographic separation makes it easier for them to divide the market amongst themselves without engaging in any unlawful activity under the antitrust laws. Railroad pricing should not be a determining factor in a shipper's ability to serve a market, but given the limited options for railroad transportation from consolidations, they have become a major component.

Although the threat of foreign competition still exists, it is largely ignored by most of the rail industry. Most of the DuPont businesses are subject to foreign competition. Our foreign competitors can choose strategically where they enter the U.S. rail system to maximize the number of carriers that will compete for their business and minimize the length of the hauls to their customers. If a foreign competitor finds that its rates are increasing out of a particular port, it can route its shipments to another, more advantageous port. The DuPont sodium business in

Niagara Falls has experienced this first hand on the Gulf Coast, where it has struggled to compete for sales against French imports because neither serving carrier will provide rates to allow DuPont to compete for that business. Perhaps the railroads view this as a zero-sum game because they will also handle the import traffic. If so, it is a very short-sighted perspective because over the long run it will force domestic plant closures, which will cost the railroads far more business than just the imported commodity. In the case of the Sodium business, DuPont is the only remaining US domestic producer.

Bottleneck segments also have lengthened because of railroad consolidation. Each merger has extended a market dominant railroad's long-haul even where the captive shipper would prefer to switch to a competing carrier at a closer junction in order to benefit from competitive rates and services.

Mergers have spawned greater use of routing protocols to increase bottleneck segments. Although DuPont recognizes that routing protocols have operating efficiency benefits and that pure open routing is not desirable, the pendulum has swung to the opposite extreme. Routing protocols should not be used to prevent shippers from using existing junctions where railroads already interchange similar traffic. When routing protocols extend a bottleneck segment, they are effectively precluding competition over a greater portion of a route. Although railroads maintain that routing protocols are necessary for efficiency, they have ignored their own protocols to preserve their long-haul, which indicates that the efficiency justification is overstated. Whereas before the Railroad Revitalization and Regulatory Reform Act of 1976 and the Staggers Act railroads were shouldering the costs of the inefficiencies in the shippers' routing, shippers are now bearing the costs of inefficiencies in the railroads' routing. It is time to swing the pendulum to the center.

In support of their merger applications, rail carriers promised that consolidation would improve service. If competition were vigorous, DuPont would have expected this to be true. But, DuPont has not experienced significant service improvements. For example, for its 2007 rail discussions, DuPont benchmarked its current transit times against 1992 transit times for the same lanes. There was no change in the transit times in this time period. But the consequence of much higher rail rates means that DuPont is now paying substantially more for the same service. This hardly indicates a competitive rail market.

Further, the resultant decrease in competition has enabled the rail carriers to ignore the difficulties that DuPont and other manufacturers have when trying to compete with unreasonable rail rates. Despite the potential consequences of these difficulties on their own traffic, rail carriers appear confident that they will obtain or retain the business, even if it is from a foreign manufacturer.

B. Intermodal Competition

The rail industry is quick to contend that it is subject to extensive truck competition. While that may be true for certain business, such as intermodal traffic, that is not true for most of the DuPont portfolio of bulk chemicals and other bulk commodities. Trucks only compete with rail in limited circumstances because they do not have the same capacity as rail, are often incompatible with the design of the DuPont facilities, are typically not preferred by customers, and have a cost disadvantage compared to rail.

First, the volumes that DuPont ships by rail would be difficult for trucks to handle. Both truck drivers and equipment are in shorter supply, which is especially true for the specialty equipment and drivers required to transport the hazardous materials that comprise a majority of

the DuPont traffic. DuPont would require multiple trucks to ship the same quantity as a single railcar.

Second, DuPont has designed its distribution network around rail. Rail is the safest and most secure mode for land transport of hazardous materials. Moreover, back when railroads sought to partner with DuPont, they touted the benefits of rail and encouraged shippers to invest extensively in the infrastructure required for rail service. DuPont has poured millions of dollars into those investments, which have included everything from the purchase of rail cars to the design of production facilities. The DuPont distribution network is heavily tied to rail and cannot be easily, quickly, or cheaply undone. Furthermore, DuPont prefers rail over truck because high volumes of trucks can cause congestion at and around the DuPont facilities, and have higher handling costs in the form of more personnel needed to load, unload, supervise and administratively handle truck shipments.

Third, just as DuPont has designed its facilities around rail, so have most DuPont customers and suppliers. For this reason, many DuPont customers specifically require rail deliveries.

The DuPont titanium dioxide business is an excellent example of how DuPont and its customers have made a commitment to rail transportation and cannot simply move to trucks. Titanium dioxide slurry is a non-hazardous material that is amenable to rail and truck shipments. But, DuPont and its customers have designed their transportation infrastructure to move this commodity by rail. Railroads, nevertheless, continue to claim that trucks offer competition on titanium dioxide shipments, completely overlooking that the facilities of DuPont and its customers cannot physically support significant truck shipments without costly redesigns.

It is unfortunate that the railroads appear to forget the substantial capital investments made by DuPont to configure its plants to rely on rail transportation, while touting their own investments as justification for higher rates. For the longest time, railroads have openly stated that “freight rail helps customers create jobs when their logistics supply chains are redesigned around the greater efficiencies of rail.”¹ But, so do the investments made by DuPont and other shippers that enable their wide-spread use of rail.

Finally, railroads have a cost advantage over trucks, especially as distance increases. Rail transportation offers efficiencies that make it difficult for trucks to compete effectively with rail at distances over 500 miles. This distance has increased in recent years not because greater truck efficiency has lowered truck costs, but because railroads have chosen to benchmark their rates against a higher cost alternative. The fact that railroads demand the truck-like rates without offering the higher service levels that trucks provide is yet another indicator that real competition is lacking.

III. DuPont Experience With Reduced Rail Competition.

For much of the thirty years since Congress passed the Staggers Act, railroads have partnered with DuPont to the mutual benefit of both their businesses. Railroads took a strong interest in growing the DuPont business because that also grew the railroads’ business. Contract negotiations were arms-length mutual exchanges of proposals marked by a willingness to listen and compromise. Around 2004, however, that partnership began to unravel.

In the most visible sign of this unraveling, rail rates jumped dramatically and have continued to increase steadily and sizably since then. Where contract negotiations used to be true negotiations, today, rates are often presented as “take it or leave it” offers. Although a

¹ E.g., Matthew K. Rose, Chairman & Chief Executive, BNSF, J. Comm., Jan. 10, 2011, at 160 (“We know freight rail helps customers create jobs when their logistics supply chains are redesigned around the greater efficiencies of rail.”).

railroad may negotiate the rates on individual lanes, they will come to the negotiating table with revenue demands for their entire book of DuPont business. Therefore, if they accept a rate reduction in one lane, they require that another lane make up for the resulting revenue shortfall. In a truly competitive market, such revenue shifting would not be possible.

The railroad incentives to partner with DuPont to grow both their businesses seem to have evaporated with some rail carriers. The prospect of new business is attractive only if that new business will pay the higher rates demanded by a railroad. If competitive rail rates are necessary to develop that new business, however, railroads are seldom interested if those rates cannot meet their desired higher levels. When new businesses don't develop or existing businesses can't grow, new jobs are not created; or worse, if rail rates help to render existing businesses non-competitive, existing jobs are lost.

The market power exerted by the rail industry is manifested in the very way that railroads now approach rate negotiations. Because of the size and scope of the DuPont rail freight business, contract negotiations historically began 12-18 months before the expiration of existing agreements with a sharing of proposals between the parties. That lead time was both necessary and desirable to permit DuPont to interact with the numerous DuPont business units for evaluation, determination of missing rates for any lanes, developing of a counter-proposal, and consideration of any railroad counter-proposals. In the majority of recent major contract negotiations, however, the railroads have failed to provide even an initial rate proposal until the last month of the existing contract. In their view, no negotiation is required.

Furthermore, some railroads have completely disassociated contract terms and conditions from rates. While one carrier was not willing to provide rates more than a month before existing contracts expired, it urged DuPont to accept general terms and conditions before receiving rates.

A second carrier refused to discuss any terms and conditions prior to rate acceptance. But there are certain contract terms that are highly contingent upon rates. While the Board cannot influence the negotiation process used by rail carriers, we share it as yet further evidence of railroads exploiting market power to dictate, rather than negotiate, commercial terms.

In addition to raising line-haul rates significantly, railroads have increased their revenues by shifting costs to, or imposing numerous new costs upon, shippers. They have unbundled services to create new accessorial charges or increased fees, such as finance charges, charges for not participating in electronic billing, weighing and diversion charges. Where railroads used to switch customer facilities or provide an allowance to the customer for such switching, the customer is most often responsible for these costs today. DuPont must now rely more extensively upon private rail cars than it has in the past, as railroad fleets have proved insufficient to the task. Regardless of the justifications for some of these charges, the point is that they are additional costs that shippers previously did not pay, and thus constitute a further increase in real transportation costs.

The greatest of these new charges has been the fuel surcharge. Although most railroads had long adjusted rates by indices that included changes in fuel costs, they opted to strip out fuel from these indices and instead assess a fuel surcharge. Initially, they calculated fuel surcharges as a percent of rates, which had no correlation to changes in fuel costs or consumption. This methodology was presented as “take it or leave it” to most shippers until the Board declared it to be an unreasonable practice for common carriage. Even today, however, this methodology still permeates some carrier rail contracts. These facts demonstrate that shippers really do not have competitive alternatives to rail when it comes to negotiating fuel surcharges. Even fuel surcharges that are now mileage-based require shippers to accept at face value railroad claims

that fuel is only included in the line-haul rate up to an artificially low strike price even though such assertions strain credulity. Studies have indicated that this ancillary revenue stream is merely padding profits rather than recovering fuel costs. The STB needs to monitor rail carrier fuel data and strengthen oversight of the rail carrier practices on the application of fuel surcharges to ensure shippers are protected from revenue enhancement.

Railroads also have forsaken long-term contracts in favor of shorter, 1-3 year agreements. As rail carriers have experienced an increase in market power, they have shied away from multi-year agreements in order to take advantage of more frequent rate increases.

Railroads are fond of the phrase “we are pricing to the market” which implies that they are subject to competition. They also cite the basic rules of supply and demand to contend that their rate increases are justified by industry capacity constraints in order to create incentives for new capacity investment. There are both competitive markets and non-competitive markets; and, investment incentives created by capacity constraints require competitive markets. Otherwise, in non-competitive markets, the incentive is to constrain output to an artificially low profit maximizing level. As a consequence, prices remain perpetually high. Because the rail industry is acknowledged to have substantial barriers to new entry, the Board must ask what incentive railroads really have to add sufficient capacity to meet demand and reduce rates. After seven years of dramatic and steady rate increases, even through a severe economic recession, the evidence would suggest that the rail industry is not subject to the levels of competition to which it pretends.

IV. Policy Changes that Will Enhance Rail Competition

To revitalize competition among railroads, the Board should embrace sweeping policy and regulatory changes that would create greater rail competition. DuPont believes that

widespread access to reciprocal switching at reasonable rates, as well as allowing shippers to shorten bottlenecks and obtain bottleneck rates, will give shippers access to a healthy, competitive, rail transportation market.

A. Reciprocal Switching

The Board's present standards for reciprocal switching are far too stringent. In *Midtec Paper Corp. v. Chicago and North Western Transportation Company*, 3 I.C.C.2d 171 (1986) [*"Midtec"*], *aff'd Midtec Paper Corp. v. United States*, 857 F.2d 1487 (D.C. Cir. 1988), the Board layered antitrust-like requirement on top of the minimum threshold adopted by Congress, in 49 U.S.C. § 11102(c)(1), for reciprocal switching. The fact that no shipper has petitioned the Board under these standards in over two decades indicates the excessive nature of these rules and the need for change. Therefore, DuPont urges the Board to reconsider and reverse the *Midtec* standards by lowering the bar closer to the minimum threshold set by the statute.

DuPont favors a system similar to Canadian inter-switching, which is available to any shipper within a defined radius at a pre-determined rate. No costly or time-consuming regulatory proceeding is required and costs are known up-front.

Reciprocal switching should be widely available in order to have the best chance of fostering greater competition. In particular, it needs to be available at origins and destinations because, so long as one end of a movement remains captive to a single railroad, the entire movement remains captive to that railroad if it also can serve the other end (unless the Board also addresses bottlenecks and routing protocols).

The Board should review the switching rates that the rail carriers charge each other when they establish interchange agreements and fees and switching at terminals already existing today. The Board could examine these charges and also establish a maximum profitability threshold to

be applied in addition to these charges as the basis for reciprocal switching charges. This methodology may create a competitive reciprocal switching rate that will enhance competition for shippers.

B. Bottlenecks

After reciprocal switching, requiring railroads to provide bottleneck rates is another policy to enhance competition. This will ensure competitive rates on lengthy bottleneck segments without requiring rate challenges to the entire route. Where a railroad continues to charge unreasonable rates for a bottleneck segment, a shipper can challenge the rate in front of the Board, which is likely to be a simpler proceeding than it is today in light of the shorter distances involved.

Any change to the Board's bottleneck policy must address routing protocols. Routing protocols can be used to undermine advances in bottleneck policy by elongating bottleneck segments, eliminating interchange points, and concentrating traffic over certain routes. Access to more routes is necessary to help shippers avoid unnecessarily long bottlenecks and keep traffic flowing in a manner that is efficient for both railroads and shippers.

V. Benefits of Enhanced Rail Competition to DuPont and the Chemical Industry

Enhancing rail competition will have a positive effect on competition within the chemical industry and benefit consumers. As a result of railroad market power, the American chemical industry is disadvantaged not just today, but also for the future. Industries, such as biofuels, will depend on a competitive and efficient rail system. Without competitive rail rates and service, the development of such industries in the United States could be delayed to our long-term economic detriment. Accordingly, greater competition is needed to ensure DuPont, other chemical

manufacturers, and American consumers are not unfairly shouldering excessive rail rates to the benefit of our nation's railroads.

Poor access to rail competition is also sending the American chemical industry offshore. Foreign manufacturers have access to competition and lower rail rates because of the many locations at which they can access the U.S. rail network. In fact, if DuPont were investing in many of its production facilities today, it would be cheaper to move its industrial Chemical production overseas and then import that production into the U.S. The country and American workers simply cannot afford to have railroads drive off DuPont and the chemical industry by stubbornly refusing to compete.

In closing, we thank the Board for the opportunity to share our views, examples and suggestions to more strongly influence policy change and promote competition in the rail industry. DuPont stands prepared to work with the Board, the railroads and others in industry to enhance rail competition and improve the efficiency of the rail transportation system on which our Nation's economic well-being so depends.

Respectfully submitted,



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